

INFORMATION BULLETIN #2

SALES TAX

MAY, 2002

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SUBJECT: Warranties and Maintenance Contracts

REFERENCE: IC 6-2.5-2-1, IC 6-2.5-3-2, IC 6-2.5-4-1, 45 IAC 2.2-4-2

Original Warranties or Dealer Warranties

Original warranties or dealer warranties warranting the condition of a product and providing that maintenance or replacement parts will be provided for either no charge or a flat charge are subject to sales tax. Original warranties and dealer warranties are not offered as an option when the product is sold and are considered part of the selling price of the product. Any parts transferred to a buyer under the terms of original or dealer warranty are not subject to the sales tax because the parts and or property are considered to have been sold with the product as a part of the retail transaction on which sales tax was collected. Examples:

1. An automobile dealer sells an automobile for \$20,000. Included in the selling price is a warranty that will cover any repairs for two years or 20,000 miles. This warranty is an original or dealer warranty. Tax is collected on the full \$20,000.
2. Same warranty as in Example 1 above. The automobile needs a new engine after 5,000 miles and six months of driving. The dealer must provide and install the engine under the terms of the warranty. No sales tax is due on the price of the engine since tax was collected on the warranty when the automobile was purchased.

Optional Extended Warranties and Maintenance Agreements

Optional extended warranties and maintenance agreements may either be purchased alone, or purchased as an option with the sale of the covered product. Typically, the terms of these

agreements provide assurances that any required service and parts will be provided in the event of a break down or malfunction of the covered product. However, some of these agreements also contain provisions for periodic inspection or preventative maintenance activities where tangible personal property will be supplied as a part of the unitary price.

Optional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are not subject to sales tax. Any parts or tangible personal property supplied pursuant to this type of agreement are subject to use tax. The supplier of the parts or property will be liable for the use tax on the parts or property because the supplier is using the material to fulfill the service called for by the terms of the warranty or maintenance agreement. A merchant that maintains an inventory of parts for resale and uses some of the parts in fulfilling the terms of the warranty or maintenance agreement should self assess use tax on any parts so used. Example:

3. Same facts as in Examples 1 and 2 above, except that the automobile dealer offers to extend the warranty on the automobile for three additional years or 30,000 additional miles for a price of \$1,500. This type of warranty is optional and is in addition to the purchase price. There is no certainty that any parts will be supplied to the buyer under the terms of the warranty, thus sales tax should not be collected on the additional \$1,500. The automobile dealer is liable for the use tax on any parts or property subsequently transferred to the buyer under the terms of the warranty or maintenance agreement.

Optional warranties and maintenance agreements that also contain provisions for periodic services where tangible personal property will be supplied as a part of the unitary price fall within the ambit of Rule 45 IAC 2.2-4-2. This Rule, interpreting IC 6-2.5-4-1, states that where, in conjunction with rendering services, a service provider also transfers tangible personal property for a consideration, this will constitute a retail transaction unless:

1. The service provider is in an occupation that primarily furnishes and sells services, as distinguished from tangible personal property;
2. The tangible personal property is used or consumed as a necessary incident to the service;
3. The price charged for the tangible personal property is inconsequential (not to exceed 10%) compared with the service charge; and
4. The service provider pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

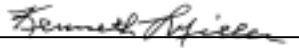
IC 6-2.5-2-1 imposes the state gross retail tax on retail transactions made in Indiana. If the provisions contained in the warranties or agreements are in complete compliance with all provisions of Rule 45 IAC 2.2-4-2, then the periodic transfer of tangible personal property will not constitute a transaction of a retail merchant constituting selling at retail. If such is the case, the service provider is not obligated to collect sales tax on the unitary price of the warranties or maintenance agreements. However, the service provider of the parts or property will be liable for the use tax on the parts or property because the service provider is using the material to fulfill the service called for by the terms of the warranty or maintenance agreement.

If the provisions contained in the warranties or agreements are not in complete compliance with all provisions of Rule 45 IAC 2.2-4-2, this will constitute a transaction of a retail merchant selling at retail. Thus, the service provider must collect sales tax on the unitary price pursuant to IC

6-2.5-2-1. Any tangible personal property subsequently transferred to the buyer under the terms of the warranty or maintenance agreement is not subject to sales tax.

Examples:

4. A computer software company sells a taxable software package to a customer. The customer also purchases an optional maintenance agreement from the company. The maintenance agreement entitles the customer to up to twenty hours of programmer help to deal with any problems the customer might have in using the software package. The maintenance agreement also entitles the customer to periodic software updates. The computer software company calculates that the price charged for the software updates is 5% compared with the service charge. The software maintenance agreement is not subject to sales tax.
5. An office supply company sells a photocopy machine to a customer. The customer also purchases an optional maintenance agreement from the company. The maintenance agreement entitles the customer to service and parts at no charge in the event of a breakdown of the photocopying machine. The agreement also provides for quarterly inspections, replacement of the drum after 100,000 copies have been made, and toner to be provided on an as needed basis. The office supply company calculates that the price charged for the above tangible personal property is 35% compared with the service charge. The sale of the maintenance agreement is a transaction of a retail merchant selling at retail and is subject to the collection of sales tax



Kenneth L. Miller
Commissioner